IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

IN RE:	**BARBARA HODES,**	**Case No. 98-20039-7**
	Debtor.	

IN RE:	**PHILLIP HODES,**	**Case No. 98-20040-7**
	Debtor.	

MEMORANDUM AND ORDER

This matter is before the Court on the Objection To Debtors' Claims of Exemptions (Doc. No. 48) filed by judgment creditors, Lawrence S. Jenkins and Roger W. Hood, M.D. (hereinafter "Creditors"). The only portion of that Objection awaiting resolution by this Court is that part dealing with the cash value of a life insurance policy that the Debtors Phillip and Barbara Hodes (hereinafter "Debtors"), claimed as exempt.[1] The parties have now submitted a Stipulation of Facts (Doc. No. 249), and the Court, after reviewing those facts, including the exhibits, the parties' briefs, and arguments of counsel, finds that this matter is ready for decision.

[1]The exemption objection initially also raised issues as to the exemption of certain jewelry, a mink coat, to one or more other insurance policies, as well as an objection dealing with retirement funds. The parties have stipulated that all pending objections to exemptions have been resolved, except the one dealing with the homestead exemption, which is on appeal, except as it relates to the one life insurance policy that is the subject of this opinion.

The pivotal issue in this case is whether that portion of a term life insurance policy, which was originally issued well more than one year before filing bankruptcy, but which was converted to a whole life policy by payment of $30,000 within one year of bankruptcy, is exempt under K.S.A. 40-414(b)(1). The Court finds that the Creditors' objection to Debtors' claim of exemption to Mass Mutual Whole Life Policy No. 11537541 should be sustained.

I. JURISDICTION

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334. This is a core proceeding. 28 U.S.C. § 157(b)(2)(B).

II. FINDINGS OF FACT

In 1993, Creditors commenced a civil action against Debtors seeking damages for breach of contract arising out of the Debtors' sale of their interest in certain corporate stock to Creditors. On November 10, 1997, a jury returned a verdict against Debtors and others, and in favor of Creditors, for $4 million, plus another $500,000 in attorney fees. Final judgment was entered November 17, 1997.

On November 13, 1997, before the judgment was even final, Debtors met with an attorney who specializes in bankruptcy matters. Very soon thereafter, Debtors began liquidating approximately $514,000 in nonexempt securities and acquiring exempt assets with the funds. See *In re Hodes*, 235 B.R. 104 (Bankr. D. Kan. 1999) and *In re Hodes*, 289 B.R. 5 (D. Kan. 2003) for a full description of the facts, which are essentially undisputed. On January 6, 1998, an involuntary bankruptcy was filed against these Debtors.

On May 26, 1998, after consenting to an Order of Relief being entered, Debtors signed their bankruptcy schedules, and in Schedule B listed an interest in the following insurance policies:

Insurance Company/Policy Number	Beneficiary	Market Value
Mass Mutual #11537541	Phil Hodes Trust	$28,567 (Mr. Hodes)
CML # 4518827	Phil Hodes Trust	$20,958 (Mr. Hodes)
CML # 6106446	Phil Hodes Trust	None (jointly owned)
Hartford # ufo905613	Phil Hodes Trust	$39,095 (Mr. Hodes)

The only policy that Creditors now object to being exempted is Mass Mutual Policy # 11537541. This is a whole life policy with an annual premium of $3,569, a basic face amount of $100,000, and a $29,646.13 cash value, as of June 9, 1998.

On December 18, 1997, approximately one month after the judgment was rendered against him, Debtor Phil Hodes completed, signed and dated a new Life Insurance Application. The Court's copy of Exhibit 17, which contains the Life Insurance Application, appears to reflect that either Hodes, or someone working on his behalf, checked two boxes at the top of the Application. One box says "New Policy as Exchange of Term Insurance," and the other box says "Conversion of Term Insurance." Mr. Hodes checked the option for "whole life" in the face amount of $100,000, and has testified that he in fact paid $30,000 in mid-December 1997 to obtain this whole life insurance policy.

In addition, on page 3 of the Life Insurance Application, next to block #22, it indicates the "Policy Date" is "12-15-97." Further the Application allowed, as # 28 Dividend Option, the option of "paid-up additions," an option that had not been available in the original term policy, according to the terms of the Application. Thus, the policy being applied for in mid-December 1997 required a new application, and had provisions different from the original policy. Ultimately, the Application resulted in a policy with a different policy number than the original policy being issued, and this portion of the policy was a whole life policy, instead of a term life policy.

On page 4 of the Application, in a section dealing with "Conversion, Exchange and Option Data," it noted that it was term insurance policy numbered 6106446 that was being converted. In that same section of the Application, the handwritten date "1-1-98" is entered following the words: "Date of New Policy." On page 5 of the Application, there is a section that indicates "Complete the following only if Evidence of Insurability is Required." Mr. Hodes completed this section.

Further, on page 6 of the Application, Mr. Hodes certified, by signing the Application, that he was giving permission for the insurance company to investigate his insurability. Accordingly, although Mr. Hodes testified that he did not have to take a physical or otherwise "qualify" for insurance in order to convert the policy, the terms of the Application, itself, controvert this statement. In addition, Mr. Hodes also signed the Application for the whole life policy, and his signature is underneath a caveat stating that "Any policy issued as a result of a material misstatement or omission of facts may be voided, and the company's only obligation shall be to return premiums paid." (Emphasis added)

Mr. Hodes testified that the policy in question had originally been a $2 million Mass Mutual policy (then known as Connecticut Mutual Life, or CML), which he had obtained in July, 1994. He further testified that the purpose for his conversion of a portion of the policy to cash value immediately after the $4 million judgment was entered against him was so that if he later could not pay the premiums, he would be able to borrow against the cash surrender value to pay future premiums and keep the policy in effect.

Finally, Mr. Hodes produced an exhibit, entitled "Schedule Page," but with no company name or logo, that Debtor's counsel argued was part of the policy in question. It indicates an "Issue Date" of July 12, 1994, and a Policy Date of December 12, 1997. The exhibit also indicates that the Issue Date is July

12, 1994 "for suicide and contestability," and that the rider date is December 12, 1997. However, a single page document that references the Massachusetts Mutual Life Insurance policy, by its correct number, admitted as part of Exhibit 17, unequivocally states that the "Issue Date" for this policy is December 12, 1997.

III. ANALYSIS

It is well-established that the exemption laws are to be construed liberally in favor of exemptions. *In re Mueller*, 71 B.R. 165, 167 (D. Kan.1987). Moreover, it is recognized that "[w]hen interpreting exemption statutes, the interpretation must further the spirit of such laws. Specifically, the Court must be 'guided by the general principle that exemption statutes are to be liberally construed so as to effect their beneficent purposes.'" *In re Lampe*, 278 B.R. 205, 212 (10th Cir. B.A.P. 2002)(quoting *Gregory v. Zubrod (In re Gregory*), 245 B.R. 171, 173 (10th Cir. B.A.P. 2000)).

Moreover, once an exemption is claimed, the burden is on the party objecting to the exemption to prove, by a preponderance of the evidence, that the exemption is not properly claimed. *In re Zink*, 177 B.R. 713, 714 (Bankr. D. Kan.1995); Fed. R. Bankr. P. 4003(c), §522(b).[2] Initially, this means that the objecting party has the burden of production and persuasion. If the objecting party can produce evidence to rebut the exemption, the burden then shifts back to the debtor to come forward with unequivocal evidence to demonstrate that the claimed exemption is proper. *See Carter v. Anderson (In re Carter*), 182 F.3d 1027, 1029 n. 3 (9th Cir. 1999)(cited in *In re Gregory*, 245 B.R. 171, 174 (10th Cir. B.A.P. 2000)).

[2]All statutory references are to the Bankruptcy Code, 11 U.S.C. § 101, et seq., unless otherwise specified.

Furthermore, when interpreting Kansas statutes, Kansas law is controlling. *See Dunivent v. Bechtoldt (In re Bechtoldt*), 210 B.R. 599, 601 (10th Cir. B.A.P. 1997) (interpreting Wyoming exemption statute). Additionally, the interpretation of statutes must be informed by the policies that structured them. *Id*. *See also In re Carbaugh*, 278 B.R. 512, 522 (10th Cir. B.A.P. 2002).

In Kansas, debtors may exempt life insurance, with no dollar limitation, pursuant to K.S.A. 40-414(a), which states:

> If a life insurance company or fraternal benefit society issues any policy of insurance or beneficiary certificates upon the life of an individual and payable at the death of the insured, or in any given number of years, to any person or persons having an insurable interest in the life of the insured, the policy and its reserves, or their present value, shall inure to the sole and separate use and benefit of the beneficiaries named in the policy and shall be free from: (1) The claims of the insured or the insured's creditors and representatives; (2) the claims of any policyholder or the policyholder's creditors and representatives, subject to the provisions of subsection (b); (3) all taxes, subject to the provisions of subsection (d); and (4) the claims and judgments of the creditors and representatives of any person named as beneficiary in the policy of insurance.

The ability to exempt such insurance, however, is limited to policies issued within one year of the bankruptcy filing. Specifically, K.S.A. 40-414(b) states:

> The nonforfeiture value of a life insurance policy shall not be exempt from: (1) Claims of the creditors of a policyholder who files a bankruptcy petition under 11 U.S.C. § 101 et seq. on or within one year after the date the policy is issued; or (2) the claim of any creditor of a policyholder if execution on judgment for the claim is issued on or within one year after the date that the policy is issued.

The 1988 Kansas Legislature eliminated the prior statutory requirement that the policy have been obtained by the debtor for the purpose of defrauding one or more of the debtor's creditors. Thus, debtors must purchase insurance policies at least one year prior to filing bankruptcy for the cash value to be exempt and protected from claims of creditors and the trustee.

Debtors first argue, by footnote, that K.S.A. 40-414(b)(1) does not even apply to them, since their bankruptcy began as an involuntary one, and thus they were not a policyholder who "files a bankruptcy petition" under the statute. As Creditors properly point out, that argument is clearly without merit because ultimately the Debtors consented to an Order for Relief being entered.

Debtors next argue that the "issue date" on the whole life policy was the date the term policy was originally issued in July, 1994, outside the one year period found in K.S.A. 40-414(b)(1). Such a finding would make the policy exempt. The Creditors, however, point out that the policy in question states on its face a policy date of December 15, 1997, and the "Date of New Policy" as January 1, 1998,[3] not July, 1994. Further, Exhibit 17 contains a document that clearly states the issue date is December 12, 1997. The Court must, therefore, determine what the Kansas Legislature meant when it used the term "issued on or within one year after the date that the policy is issued" in the context of a converted insurance policy.

Both the Bankruptcy Court and the United States District Court for the District of Kansas were faced with a similar fact pattern in the case of *Peoples State Bank v. Sayler*. In that case, the Bankruptcy Court found that the debtor's conversion of a term life insurance policy to a whole life policy constituted the issuance of a new policy. *Peoples State Bank and Trust Co. v. Sayler (In re Sayler),* 68 B.R. 111, 117-18 (Bankr. D. Kan. 1986). The court also found that the new policies were taken out in order to defraud the debtor's creditors. *Id.* at 122.[4] The debtor appealed the Bankruptcy Court's findings to the

[3]Regardless of whether this policy was issued in December 1997 or January 1998, the result would be the same for the Debtors; either date is within one year of the date the Order for Relief was entered herein.

[4]Under Kansas law at the time of the *Sayler* case, K.S.A. 40-414(b)(1) required a showing both that the policy was issued within one year of filing bankruptcy and that the policy was obtained by the debtor for the purpose of defrauding one or more of the debtor's creditors. *Sayler*, 68 B.R. at 118

District Court, which affirmed the Bankruptcy Court's holding that the conversion of the term life insurance policies to whole life policies in that case constituted the issuance of new policies within the meaning of K.S.A. 40-414(b)(1). *Peoples State Bank & Trust Co. v. Sayler (In re Sayler)*, 98 B.R. 536, 539 (D. Kan. 1987). The District Court reversed and remanded the case solely on the basis that the Bankruptcy Court had employed an erroneous legal standard when deciding whether the policies were obtained with the intent to defraud creditors. *Id.* at 541.[5] Like in this case, the policies at issue in *Sayler* were term policies that were converted to universal life policies within one year of bankruptcy. Both the Bankruptcy and District Courts, relying on *Fisher v. Central Surety & Ins. Corp.*, 149 Kan. 38, 46 (1939), held that the word "issue" meant the date when the insurance policy came into full effect and operation as a binding obligation.

Debtors suggest all the Court need do to determine that this policy was a continuation of an older policy, and not a new one issued within one year of bankruptcy, is to look at the date on the face sheet, or "Schedule Page," of the reissued policy. To determine whether a subsequent policy is a renewal or a new, separate policy, however, requires more analysis. A major factor in such determination is the degree to which the policies differ and the surrounding circumstances for the issuance of the second policy.

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n.7. Section 40-414(b)(1) was amended in 1988 to remove the fraud requirement and now requires only a showing that the policy was issued within one year of filing bankruptcy. *See* K.S.A. 40-414(b)(1) (2000).

[5]On remand, the Bankruptcy Court applied the standard for fraud dictated by the District Court and again found that the debtor's actions were fraudulent within the meaning of K.S.A. 40-414(b)(1). *See Peoples State Bank and Trust Co. v. Sayler (In re Sayler)*, 100 B.R. 57, 63 (Bankr. D. Kan. 1988). This holding was affirmed by the District Court and the policies were held to be non-exempt. *See Peoples State Bank and Trust Co. v. Sayler (In re Sayler)*, 98 B.R. 542, 548 (D. Kan. 1989).

The Kansas Court of Appeals, in *Sonderegger v. United Investors Life Ins. Co.*, 16 Kan. App. 2d 764, 771 (1992), for example, held that additional coverage provided by a substituted policy issued after the insured filled out an application converting the original policy was, in fact, a new policy, and not one just continuing coverage. The decision was relevant in that case because the finding that it was a new policy caused the two year suicide exclusion to re-commence upon issuance of the "new" policy.

The Court finds numerous indicia that the policy in question was "issued" within one year of bankruptcy, as that term is used in K.S.A. 40-414(b)(1). First, Debtor Phil Hodes was required to complete and sign, under penalty of voiding the policy, a new application for the whole life policy, as opposed to merely asking the insurer to use the prior application for the conversion. Second, the policy number for the whole life policy changed after conversion, indicating that the insurance company treated it as a separate, distinct and new policy on its records. Third, the Application required Hodes to give a medical release to allow the insurance company to determine his insurability for the policy, and he gave that medical release. Fourth, the Application, itself, referred to this policy as a "new" policy. Fifth, the second to last page of Exhibit 17, which contained the Application as well as a few other related pages referencing this new policy with its new number, cash value, etc., specifically noted its "issue date"—the same words used by the Legislature in the amendments to K.S.A. 40-414(b)(1), as December 12, 1997. Sixth, according to the Application, the new whole life policy would allow "paid-up additions," which was a change from the prior term policy. Finally, by definition, whole life insurance is by its nature different from term insurance, and a portion of the prior policy was, in fact, converted to a whole life policy upon payment of $30,000 within the statutorily prohibited time period.

The Tenth Circuit had an opportunity to consider a similar issue in *Binkley v. Manufacturers Life Ins. Co.*, 471 F.2d 889, 891 (10th Cir. 1973). In that case, after a medical examination, the insurer issued a new individual policy containing a total disability waiver benefit provision and a double indemnity accidental death provision, for a face amount increased from $12,000 to $15,000. The court concluded that the new policy was not a continuation of the old policy because the terms of the new policy were not "in strict accord" with the provisions of the group policy, but differed therefrom in substantial particulars. *Id.* at 893.

Similarly, this Court finds that the policy in question is not "in strict accord" with the prior policy, and thus is not exempt under K.S.A. 40-414(b)(1). Further, it seems clear that the Kansas Legislature, in amending the life insurance exemption to include essentially a presumption of fraud if a debtor tries to exempt the cash value of insurance obtained within one year of bankruptcy, intended to legislatively overrule the original *Peoples State Bank & Trust Co. v. Sayler* District Court decision, which remanded for certain additional evidence of fraud. *See* Exemption Laws in Kansas: Recent Amendments and Bankruptcy Estate Planning, 38 Kansas Law Review 143,154 n.98 (1989) (concluding that the May 6, 1988 amendments to K.S.A. 40-414 were "apparently a direct response to *Peoples State Bank & Trust Co. v. Sayler*"). The Legislature, by removing the requirement to prove fraud, made it clear that it did not intend to exempt insurance obtained within one year of bankruptcy, regardless of the debtor's motive.

Mr. Hodes testified in a deposition, which was admitted into evidence by stipulation, that his decision to place $30,000 in a whole life insurance policy immediately before bankruptcy, at a time when he admitted, in his bankruptcy Schedule B-Personal Property, that he already had $60,053 in whole life policies, and upwards of $2 million in term insurance, and at a time when his creditors were seeking

repayment of a significant monetary judgment, was so that he would be sure he had the ability to pay the premiums in future years.[6] Regardless of his motive, the Kansas Legislature, in amending K.S.A. 40-414(b)(1) in 1988, has made it abundantly clear it will no longer allow debtors to exempt such policies.

IV. CONCLUSION

The Court finds that Mass Mutual issued the Debtors a new policy, Mass Mutual Policy No. 11537541, on December 12, 1997, which was within one year of the filing of the bankruptcy petition in this case. Therefore, the Creditors' Objection to Debtors' Exemptions, as it relates to that policy, with a cash value of $29,646.13 as of June 9, 1998, is sustained.

IT IS, THEREFORE, BY THIS COURT ORDERED that the present nonforfeiture, or cash, value of Mass Mutual Policy No. 11537541 should be turned over to the trustee herein for distribution. This Memorandum shall constitute findings of fact and conclusions of law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based on this ruling will be entered on a separate document as required by Rule 9021 of the Federal Rules of Bankruptcy Procedure and Rule 58 of the Federal Rules of Civil Procedure.

IT IS SO ORDERED this 17th day of April, 2003.

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[6]To that end, Mr. Hodes' testimony on this issue partly contradicted the contents of the insurance application he completed December 18, 1997, wherein he indicated that he had a $2 million Connecticut Mutual Life (CML) policy, a $194,334 CML policy, and a $70,580 Hartford Policy. As a side matter, this Court would generally assume most 58 year old men with no dependents would find ownership of over $2.25 million in insurance adequate, if merely maintaining adequate insurance was the true motive for this conversion of cash to insurance. Since a debtor's motive in obtaining cash value insurance within a year of bankruptcy is no longer relevant under applicable state law, however, the Court makes no finding about Debtor's motive in partly converting a portion of this insurance policy to one with a cash value on the eve of bankruptcy.

Janice Miller Karlin
United States Bankruptcy Judge

CERTIFICATE OF SERVICE

The undersigned certifies that copies of the **Memorandum and Order** was deposited in the United States mail, postage prepaid on this _____ day of April, 2003, to the following:

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